

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
April 18, 2003
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Mr. Karl Polen, Chairman, Arizona State Retirement System Board, called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call, Opening Remarks

Present: Mr. Karl Polen, Chairman
Mr. Norman Miller, Vice-Chairman
Ms. Charlotte Borchert
Mr. Jim Bruner
Mr. Carl Tenney
Mr. Steven Zeman
Dr. Keith Meredith
Mr. Lawrence Trachtenberg

Excused: Dr. Chuck Essigs

A quorum was present for the purpose of conducting business.

2. Approval of Minutes of the March 21, 2003, Regular Meeting of the ASRS Board

Motion: Mr. Jim Bruner moved to approve the minutes of the March 21, 2003, regular meeting of the ASRS Board.

Mr. Carl Tenney seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

3. Approval of Consent Schedule

Motion: Ms. Charlotte Borchert moved to approve Refunds, Death Benefits, Retirements, System Transfers, and the Application and Agreement with Central Yavapai Fire District.

Mr. Jim Bruner seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

4. Presentation, Discussion and Appropriate Action of ASRS Internal Operations Quarterly Briefing

This agenda item was postponed until a later date.

5. Presentation, Discussion and Appropriate Action Regarding the Recommendation of External Audit Services

Mr. Carl Tenney, Vice Chairman, Budget and Audit Committee, explained that the Budget and Audit Committee is recommending approval of the contract award for external audit services to Deloitte & Touche. Mr. Tenney stated that the Committee was concerned about the fact that this was the sole proposal received by the ASRS. The Committee was also concerned with the fact that Deloitte & Touche has been the ASRS' external auditing vendor for 15 of the past 16 years. While the Committee supports this contract award, the Committee requests the ASRS staff conduct a study, within the next 180 days, to determine whether a request for proposal (RFP), in the next 6-12 months, might yield competitive proposals.

Ms. Charlotte Borchert, a member of the Budget and Audit Committee, stated she is very concerned about the process for this bid. She believes the reason we did not receive other bids is that the other vendors are assuming that the ASRS has already made their decision before the RFP process even begins. Additionally, due to the fact that only one proposal was received by the ASRS, the Board must put forth substantial reasons for concluding the process and hiring the sole vendor. Additionally, Ms. Borchert stated that although Deloitte & Touche has done a good job, she believes that no agency should utilize this type of vendor for this length of time and will have to vote no on this agenda item.

Motion: Mr. Carl Tenney moved that the Board select the firm of Deloitte & Touche as the annual auditors in the amount of \$85,000 and that the Board direct ASRS staff to conduct a study during the next 180 days to determine under what circumstances if any other proposals might be received.

Mr. Bruner seconded the motion.

By a vote of 6 in favor, 2 opposed, 0 abstentions, and 1 excused, the motion was approved.

6. Board Hearing and Action by the Board Regarding the Request for Hearing of Ms. Christina Canez

Mr. Karl Polen, Chairman, requested this item be held until the Board has ample time to review the documents pertaining to Ms. Canez' case. He further requested that the ASRS staff prepare a summary report of this information and present it at the next Board meeting.

7. Presentation, Discussion and Appropriate Action Regarding the Legislative Update

Ms. Kelly Orrick, Legislative Liaison, stated that the ASRS has four bills that are currently in the final stages for passage. The Senate Bill pertaining to rural health insurance (SB 1036) is currently dead. The House version (HB 2349) in its current form has minimum out-of-pocket premium contributions that have to be made by each rural member in order to qualify to receive the rural subsidy.

The ASRS; Surviving Spouses; Health Insurance bill (SB 1037) is scheduled to go to final read. This bill has been amended through the process to be actuarially neutral and to provide administrative cost coverage for the ASRS to implement.

The Supplemental Defined Contribution Plan amendments (SB 1224) has been referred to a conference committee because there is another private-sector lobbyist who is interested in making an amendment pertaining to matching funds to an employee's contribution to another plan. The final determination on this amendment has not been completed.

The Contributions Not Withheld bill (HB 2026) is in the final read stages. The Service Purchase bill (HB 2024) is scheduled for the Committee as a Whole.

Mr. Richard Stephenson explained that the military service refund bill was drafted to ensure some members that purchased service credit at a higher rate would be refunded the difference between the higher rate and the rate paid today. This bill will include those members who purchased military time.

There has been no movement on the terrorism funding bills (SB 1296, HB 2397, & HCR 2029).

8. Presentation, Discussion and Appropriate Action Regarding Approval of the Notice of Recodification for Publication by the Secretary of State

Mr. Richard Stephenson stated that this is a request for the Board to take action on adopting a Notice of Recodification. Per Susan Alandar, Rules Writer, this is a correction of a numbering error that currently exists within the Board rules that are published with the Secretary of State.

Motion: Mr. Norman Miller moved to approve the Notice of Recodification for filing with the Secretary of State.

Dr. Keith Meredith seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

9. Presentation, Discussion and Appropriate Action Regarding the Notice of Proposed Rule Making for Publication by the Secretary of State

Ms. Alandar stated that approval of the Notice of Proposed Rule Making will begin the formal rule making process of R2-8-123 which contains the Board's actuarial assumptions and values of assets.

Motion: Mr. Norman Miller moved to approve the Notice of Proposed rulemaking as presented for filing with the Secretary of State and amend the motion to delete the table on Page 5 in rule R2-8-123 (1B) and insert the stricken language "The 1983 Group Annuity Mortality Table" with margins set back one year for males and not set back for females. Additionally, Table 3 would be deleted and existing tables renumbered.

Mr. Jim Bruner seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

10. Presentation, Discussion and Appropriate Action Regarding the Following Draft Rules

Draft Rules "A"

The rules being proposed seek to establish agency policy for the circumstances under which the ASRS will make reductions to System members' accounts. It also describes the manner in which a System members' accounts will be reduced and the portions of a System member's account that are subject to reduction.

The ASRS has not yet faced a circumstance where System member benefits had to be reduced. In fiscal year 2002, investment returns were lower than the 8% assumed rate, however, an actuarial valuation of the System found it to be sufficiently funded and able to absorb the loss. As a result, the Board voted not to reduce or increase System members' benefits. The recent volatility of the equities markets and forecasted underperformance for fiscal year 2003 necessitates that the ASRS prepare to reduce benefits for System members in the fall of 2003. System members were notified in the winter of 2002 that reductions were likely in 2003 and that the ASRS would be drafting proposed rules and seeking public comment in 2003.

Mr. Carl Tenney, Dr. Keith Meredith, and Mr. Karl Polen wish to sit on a committee to review the above-mentioned rules.

Draft Rules "B"

Ms. Alandar explained that the Board is required by law to have rules pertaining to administrative appeals. Currently, there is one rule addressing hearings and it is outdated. Ms.

Alandar stated that this is a request for a group of rules addressing the entire appeal process for use for all members, including employers to appeal decisions by the Director to the Board. In summary, the draft rules do the following:

- Allow the Board to conduct hearings in a formal manner rather than as a court, and establish the process for conducting and recording a hearing.
- The draft rules prohibit *ex parte* communication.
- Establish what must be included in a request for hearing, and that the written request has to be filed and docketed in the office of the Director.
- As required by law, the hearing must be held within 60 days of receiving an appeal, and the appellant has to be notified of the important details at least 30 days before the hearing.
- Written decisions by the Board must be issued within 20 days after a hearing, and as required by law, must contain a concise explanation of the reasons supporting the Board's decision.

Mr. Norman Miller will assist the ASRS staff in reviewing these rules.

Draft Rules "C"

The proposed rules have been extensively researched by the ASRS staff and are based upon procedures in place, with the exception of a new provision within proposed draft rule 09, addressing service purchase by payroll deduction agreement. Since the inception of this method of payment, a minimum purchase per pay period of .001 year of service has been required. The ASRS staff is proposing a change that would establish a minimum of \$10 per pay period in the event that the .001 year of service amounts to less than that.

Many of these draft rules necessarily establish time procedural periods and deadlines for employers, members, and the ASRS. In all cases the ASRS has sought to establish timelines that are within the agency's Strategic Plan and/or that are reasonable for all parties involved.

Ms. Charlotte Borchert and Dr. Keith Meredith both indicated that they would like to sit on a committee to address the above-mentioned rules (C). Ms. Borchert believes that currently there are "loopholes." While she has been on the Board, she has been asked by members how rules are applied. This type of rule will affect a number of members and she would like to know if there will be hearings at various sites. Mr. Polen appointed Ms. Borchert as Chairperson of this committee.

11. Director's Report

Mr. Paul Matson, Director, had no comments to add regarding the Director's Report.

12. Presentation, Discussion and Appropriate Action Regarding the Performance of International Managers for the Period Ending December 31, 2002

Mr. Terry Dennison, Principal, Mercer Investment Consulting, reported on the performance of Bank of Ireland, Brandes, Capital Guardian, Barclays Global Investors (BGI), and Bank of New York Asset Management (BNYAM) for the period ending December 31, 2002.

Mr. Chris Reilly, Director, Chief Investment Officer, and Mr. Daniel Anderson, Vice President, Client Services, reported on Bank of Ireland's performance for the period ending December 31, 2002.

Total Rate of Return	Quarter	1 Year	3 Years	Inception (10/01/98)
Country Weightings	0.8	0.1	1.3	-1.2
Stock Selection	-0.7	-2.9	2.5	4.9
Hedging	0.0	-0.4	0.1	-0.1
Fees (%)	-0.1	-0.3	-0.3	-0.3
Other (Currency)	-0.1	1.2	-1.7	-0.7
Total Value Added	-0.1	-2.3	1.9	2.6

Mr. Charles Brandes, CFA, Managing Partner, and Mr. Ian Sunder, CFA, Portfolio Manager, reported on Brandes' performance for the period ending December 31, 2002.

Total Rate of Return	Quarter	1 Year	3 Years	Inception (9/30/98)
Country Weightings	0.5	4.7	3.1	3.5
Stock Selection	0.4	0.1	6.3	8.1
Currency	-0.2	-4.5	-0.7	-0.9
Fees (%)	-0.1	-0.3	-0.4	-0.4
Other	-0.2	-0.4	-0.2	
Total Value Added	0.4	-0.4	8.1	10.3

Mr. Michael Nyeholt, Senior Vice President, and Mr. Robert Ronus, Vice Chairman of the Board, reported on Capital Guardian's performance for the period ending December 31, 2002.

Total Rate of Return	Quarter	Cal. Ytd.	1 Year	3 Years	5 Years	Inception (6/30/92)
Country Weightings	0.5	3.3	3.3	2.6	2.7	1.6
Stock Selection	2.8	-1.6	-1.6	-2.7	3.3	1.8
Hedging	0.0	-0.2	-0.2	0.0	0.0	0.0
Currency	-0.1	-1.5	-1.5	-0.3	0.2	0.1
Fees	-0.1	-0.4	-0.4	-0.4	-0.4	-0.4
Total Value Added	3.2	-0.4	-0.4	-0.8	5.9	3.1

Mr. David Lissek, Principal Client Relationship Officer, reported on BGI's performance for the period ending December 31, 2002.

	Quarter	1 Year	3 Years	5 Years	Inception (5/31/96)
ASRS Net Return	6.47	-15.73	-17.03	-2.68	-1.48
Benchmark Return	6.48	-15.66	-17.00	-2.61	-1.36
Total Value Added	-0.01	-0.07	-0.03	-0.07	-0.12

Mr. Kurt Zyla, Vice President, Mr. Robert Windsor, Vice President, and Mr. Seth Lynn, Consultant, reported on BNYAM's performance for the period ending December 31, 2002.

	Quarter	1 Year	3 Years	5 Years	Inception (07/01/92)
Country Weightings	0.0	0.0	0.0	0.0	0.0
Stock Selection	-0.8	0.9	1.3	1.6	1.2
Hedging	0.0	0.0	0.0	0.0	0.0
Fees	0.0	-0.1	-0.1	-0.1	-0.1
Value Added	-0.8	0.8	1.2	1.5	1.1

13. Board Requests for Agenda Items

None.

14. Call to the Public

There were no members of the public who requested to address the Board.

15. The next ASRS Board meeting is scheduled for Friday, May 16, 2003, at 8:30 a.m. in the 10th Floor Board Room of the ASRS Offices at 3300 N. Central Avenue, Phoenix, AZ 85012

16. Adjournment of the ASRS Board.

Mr. Karl Polen, Chairman, adjourned the April 18, 2003, meeting of the ASRS Board at 11:58 a.m.

ARIZONA STATE RETIREMENT SYSTEM

Marina Chaves, Secretary

Date

Paul Matson, Director

Date